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**CONSTRUCTION INDUSTRY FEDERATION NATIONAL
CONFERENCE 'BUILDING FOR THE FUTURE OF THE
CONSTRUCTION SECTOR' Friday, 28th September 2012 :
Address by Mr. Brendan McDonagh, Chief Executive of NAMA**

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CONSTRUCTION INDUSTRY FEDERATION NATIONAL CONFERENCE

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Friday, 28th September 2012

Address by

Mr. Brendan McDonagh, Chief Executive of NAMA

NAMA – Contributing to Recovery

Welcome

Good morning ladies and gentlemen. I am pleased to have been invited to this morning’s event, which provides me with an opportunity to outline how NAMA, while pursuing its commercial objectives, can make a contribution to greater activity in the property and construction sectors and in the economy in Ireland more generally. Today’s conference is timely as there are now more reasons to be positive about the outlook for Ireland than we have had for some time. We have been through a very painful five years and we are far from being out of the woods yet but, at least abroad, Ireland is now seen as a story of recovery rather than of crisis and decline. Our debt yields are again approaching levels which would enable us to return to the international debt markets. Investors are again interested in buying Irish assets, including commercial property where yields have become very attractive relative to Euro government bonds. Of course, the legacy of the Tiger years will not evaporate overnight, however much we might wish that it was all a bad dream. However, crucially we are tackling our problems head on and that is being recognised very emphatically abroad.

In terms of NAMA, I would describe what we are trying to do as twofold. First, we must, at a minimum, recover for the taxpayer what has been spent in terms of acquiring our loans and enhancing the assets securing them. Second, we must contribute in any way we can to the broader economy, through our support for construction projects and through other initiatives.

As regards the first of these objectives, we redeemed another €2 billion of Senior Bonds in June, bringing the total redeemed to date to over €3.5 billion. Our strong cash position means that additional debt repayments are likely before the end of the year and that we are very well placed to meet our target of repaying €7.5 billion of NAMA Bonds by the end of 2013. This is a commitment under the country's agreement with the Troika and is important in terms of investor perceptions of Ireland at this crucial point in our recovery cycle.

But we are not doing all this in a vacuum. Because of our scale, we have to be mindful of our wider impact on the economy and, indeed, our success in meeting our ultimate objective is closely linked to what happens in the Irish economy and property markets over the remainder of this decade. NAMA, of course, is not a spectator; nor is it the hurler on the ditch who has the luxury of deriding the players on the pitch. We see ourselves as key motivators who recognise our role in making whatever contribution we can towards instigating a renewal of sustainable activity in the property market. We also plan to contribute significant levels of loan finance over our lifetime so as to preserve and enhance Irish assets securing our loans and a sizeable portion of our cash reserves will be recycled and used for this purpose.

Capital Investment Programme

The combined effects of NAMA's funding plans and market initiatives, alongside the State's capital investment programme and the commercial and residential property measures introduced by the Minister for Finance in last year's budget, can be expected to contribute to the restoration of more normalised levels of construction output in Ireland over the medium-term. But we have to be realistic about what this means and the timeframe within which this objective can be achieved. Everybody in the room would accept that the property and construction sectors, at their peak in Ireland, totally overshot what would be considered a normal level of output, particularly over the period 2004 to 2008. We cannot afford to repeat the mistakes of the past.

The legacy from this period is graphically illustrated by the unfinished and half-finished housing developments that dot the landscape in many parts of the country – NAMA has a role in about 10% of the unfinished developments and we are actively working with local authorities to find resolutions to these. However, all segments of the property market, not just

residential, continue to be affected to varying degrees by oversupply in certain areas, despite five years of consecutive declines in construction output. That oversupply has to be worked through.

But it is not an even picture. Realistically, some of the current oversupply of property will never be occupied – it is located in places where there is little or no demand. From NAMA's perspective, I would point out that 90% of the properties securing our loans is based in Dublin, Cork, Limerick, Galway and the Dublin commuter counties. In certain areas and market segments, we are seeing the probability of supply shortages before too long. Therefore, our proposed €2 billion of funding will have to be strategically targeted at meeting medium-term supply shortages, be it in the commercial or residential sectors.

The strong regional dimension to the problem of oversupply is, particularly pronounced in the residential property market. This has been acknowledged by the CIF on a number of occasions. Census 2011 shows a wide range of vacancy rates across the country, ranging from 5.4% in south Dublin to levels well in excess of 50% in parts of the north-west and midlands. Earlier in the year, the decision was made to demolish an apartment block within a Longford development controlled by a NAMA receiver to deal with substantial health and safety issues – the decision was made in consultation with the local authority. It was a question of trying to make life better for people living within the development; now that the rubble has been taken away and the area reseeded and landscaped, it undoubtedly will. It is likely that there will be other, similar demolitions in other developments to deal with health and safety issues.

The problem of oversupply is, as I suggested earlier, uneven. In the major centres of economic activity, oversupply is becoming less of an issue. The outlook is more positive when account is taken of recent population trends. The total number of people living in Ireland has increased by more than 341,000 since the Census in 2006, 100,000 more than the Central Statistics Office had originally expected. The annual natural increase in the population is of the order of 45,000. Taken in conjunction with household formation of 25,000 to 30,000 per annum and with new housing output currently running at less than 10,000 per annum (mainly one-off rural houses), this clearly has implications for housing demand in the major urban areas where future population increases will be concentrated.

NAMA will contribute loan finance over the next four years to projects which are designed to meet medium-term supply shortages, be it in the commercial or residential sectors. We have previously indicated that the potential scale of this funding is, given the right commercial opportunities, at least €2 billion, representing a very substantial injection of capital into the construction industry and the economy. A feature of this investment is its ability to be recycled from completed to new developments. A further feature is that 100% of the finance will go towards construction. There won't be any site costs or other ancillary purchases that normally have to be factored into development costings.

This funding makes not only economic sense for the wider economy but also makes commercial sense for NAMA. We will invest where the return on the investment is greater than that available from alternative options, including selling the asset in its current state or waiting for market improvements. We have already approved advances of over €610 million to complete Irish developments in residential, commercial, retail, leisure, and healthcare sectors, including €75 million advanced for the completion of residential projects in south Dublin and nearly €60 million to complete commercial projects in north Dublin, Laois, Waterford and Cork.

An area that is receiving a lot of our attention at the moment is the current and prospective demand for prime Dublin office space. Speaking at the launch of the IDA's annual report in July, the Agency's Chief Executive Barry O'Leary, looking over a medium-term time horizon, stated that "office space will actually become a challenge for us". NAMA's Asset Management Division is actively examining potentially suitable sites for modern office development within Dublin's central business district. We are working closely with the IDA and the Dublin local authorities on this. This morning's audience does not need to be told that to achieve the planning to meet the demand likely to surface in 2015 and 2016, work has to begin now.

Commercial Property Market

We see our role as being broader than funding. Part of our job is to instigate market activity, in so far as we can do so without creating market distortions. Since our inception, we have announced a number of strategic initiatives designed to support sustainable recovery in our commercial and residential property markets.

We plan to make up to €2 billion in vendor finance available over the next four years to prospective purchasers of commercial properties held by our debtors and receivers, a significant proportion of which will relate to property in Ireland. The potential impact of this €2 billion is highlighted by the fact that investment in Ireland's commercial property market in 2011 totalled just €200 million. NAMA will be investing of the order of €4 billion in the Irish economy over the next few years through our loan and vendor finance.

We expect to be in a position to announce the launch of a Qualifying Investor Fund (QIF) before the end of this year, subject to the usual regulatory approvals. The aim is to establish a regulated vehicle that is attractive to institutional investors who do not wish to own property directly. The QIF will be independent of NAMA with its own Board. It will make its own decisions based on the best interests of its investors and will have total discretion as to whether it purchases its properties from NAMA or elsewhere. Either way, by attracting additional investment into the market, it will benefit everybody.

We believe that the prospects for the Irish commercial property market are more positive than at any time over the past five years. Because of the 65% drop in prices over that period commercial property valuations, particularly for office and industrial investment, look attractive and yields of over 8% must now be compellingly appealing to potential investors at a time when 5-year Euro Government Bond yields are 3% or less.

The market's attractiveness is also being helped by the changing international perception of Ireland and the desire amongst institutional investors, after a period of retrenchment, to spread their real estate risk more widely. The measures introduced by the Minister for Finance in last year's budget on stamp duty, capital gains tax and upward only rent reviews are also very supportive.

Our recent experience is that many of the investors who turned away from the country four or five years ago are now returning with an interest in investing in Irish debt and in Irish property assets. These investors have taken the view that Ireland has turned the corner; in particular, they recognise that Ireland is ahead of the curve in terms of the restructuring of our banking system, the necessary readjustment in our property markets and progress in tackling the fiscal deficit.

Residential Property Market

The residential property market is more closely bound up with trends within the domestic economy. Our experience is that, despite reductions of up to 60% in prices in Dublin, demand continues to be constrained by concerns about future price movements, uncertainty over job and income security and tighter conditions for mortgage lending.

Last May, we launched a deferred payment mortgage initiative on a pilot basis in respect of 115 houses across developments in Dublin, Meath and Cork. This was designed to address concerns amongst prospective buyers about future house prices. We are satisfied with the pilot programme and, based on the experience, the NAMA Board has recently agreed to extend the initiative so that it applies, on phased basis, to some 750 houses within our residential property portfolio. We will shortly be announcing the details of the next phase of this initiative.

When you consider the complex interplay of economic, financial, fiscal and personal considerations that impinge on house purchase, it becomes clear that it is very difficult to be prescriptive about what will and won't work in the residential property market. In reality, a number of things are needed, of which confidence is perhaps the most important. In this regard, many of the factors that will shape the outlook for the residential property market over the short-term are outside of our own control. However, our own experience in terms of the strength of the rental market in the main urban centres may well be a positive bellwether for the future. In the past two years, we have secured tenants for 4,000 previously unoccupied apartments and the annual rent roll across our residential portfolio is of the order of €100 million. We are investing to complete apartment blocks in areas of Dublin such as Sandyford in response to strong rental demand and we have also been approached by overseas investors who are interested in purchasing large blocks of apartments with a view to their long-term rental.

Whilst the prospects for the residential market within certain key growth areas are positive, it is unlikely that we will experience a dramatic recovery in prices in the immediate future; our current expectations are that prices are likely to continue to fluctuate within a fairly narrow

corridor over the next twelve months. This is reflected in the fairly static price trends that are emerging from the Residential Property Price Index.

Social Housing

We are at a very advanced stage in terms of transferring residential units, through our debtors, receivers and directly, to the State for social housing provision under the Social Housing Leasing Initiative. Demand has already been confirmed by approved housing bodies for over 1,200 houses and apartments from the 2,000 units identified by NAMA last December as being available and potentially suitable for social housing provision. In June of this year, we identified further units bringing the total identified to nearly 3,800. These additional units are now being assessed by the housing bodies.

I earlier referred to the problem of unfinished housing developments. On a positive note, the work of the National Co-ordination Committee, which emerged from the Report of the Advisory Group on Unfinished Housing Developments and on which the CIF is represented, has made significant progress towards remediating the most problematic unfinished estates around the country. NAMA has funded works on 29 developments controlled by our debtors and receivers that needed the most urgent remedial works at a cost of €3 million.

We have also been approached recently by potential investors who have identified commercial opportunities linked to the purchase and completion of unfinished housing developments, particularly in coastal areas and close to provincial towns with large student populations. What is really positive is that the proposals that we have seen involve not just to the completion of developments but also their enhancement through a combination of design and engineering solutions.

NAMA Property Portfolio

I alluded earlier to the fact that the property assets securing our loans are well located, both within Ireland and internationally and this will be a major driver of our capital investment plans and the property market initiatives that we are developing. In Ireland, €11 billion of the €17.5 billion of assets securing our loans are located in Dublin, a further €2 billion are in Cork and the vast majority of the remaining portfolio is in the counties closest to Dublin and

the other major urban centres of Waterford, Limerick and Galway. In Britain, there is a heavy concentration of property in London area. Outside of Ireland and Britain, the bulk of assets - nearly 60% - are located in Germany and the US.

Another feature of our portfolio is that 71% of our properties can be classified as income producing investment assets with just 29% as land and development.

Our asset disposal strategy has been informed by this distribution. Our approach, in summary, has been to encourage debtors to sell assets in liquid markets such as Britain, whilst investing in our assets in Ireland to enhance their attractiveness as a future investment proposition and to increase the value that can be realised from their ultimate sale.

Conclusion

After the pain of the last five years, now hopefully we can look forward to some gains. The adjustment that has taken place in the economy means that Ireland is more competitive and is well placed to take advantage of improvements in the global economy. As we move forward, we can expect to see economic activity broaden out, from being overwhelmingly export-driven to include recovery in the domestic economy. This is vital for employment, particularly in construction which has taken a severe hit.

In Ireland, the decline of the property and construction sector and the associated consequences has been particularly acute and the sector's excessive borrowing and overproduction has been well-chronicled by now. However, the readjustment that this has necessitated in the sector is now well underway and the medium- and longer-term prospects for the property markets and for the construction industry in Ireland are positive.

The Government's recently announced €2¼ billion infrastructure package to complete further investment in a range of projects and sectors, including education, health and transport, together with our plans in NAMA, will provide a significant boost to the sector. A functioning property market and a vibrant construction industry are an integral part of any economy and a vital part of any recovering economy. I have no doubt that the sectors represented here this morning will make an important contribution to returning this economy to sustainable growth. We, in NAMA, directly and through our debtors and Receivers, will

play our part in supporting a more efficient and sustainable market and in funding new construction in response to the needs of the economy. I know that the CIF will play its part also by maintaining competitiveness and ensuring that a high degree of quality is delivered on budget and on time.

Thank you.